

WAYNE STRUMPFER
Acting California Corporations Commissioner
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Attorneys for Complainant

BEFORE THE DEPARTMENT OF CORPORATIONS
OF THE STATE OF CALIFORNIA

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| In the Matter of |) | FILE NO. 923-3805 |
| |) | |
| THE CALIFORNIA CORPORATIONS |) | |
| COMMISSIONER, |) | |
| |) | STATEMENT IN SUPPORT OF ORDER |
| Complainant, |) | LEVYING ADMINISTRATIVE PENALTIES |
| v. |) | PURSUANT TO CORPORATIONS CODE |
| |) | SECTION 25252 |
| VERONA CAPITAL MANAGEMENT, LLC, |) | |
| |) | |
| Respondent. |) | |
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| |) | |
| |) | |

Wayne Strumpfer, the Acting California Corporations Commissioner (“Commissioner”) of the Department of Corporations (“Department”) alleges and charges as follows:

1. Verona Capital Management, LLC (“VCM”) holds a valid and unrevoked investment adviser certificate issued by the Commissioner pursuant to Corporations Code section 25230 on March 17, 1999. VCM is an investment adviser business located at 1821 Wilshire Boulevard, Suite 110, Santa Monica, California 90403. Michael J. Armijo (“Armijo”) is the president of VCM.

2. On January 12, 2004, the Commissioner commenced a regulatory examination of VCM. The examination revealed violations of regulations promulgated pursuant to the Corporate Securities Law of 1968, found at Corporations Code section 25000 et seq.

3. VCM failed to prepare and maintain monthly trial balances and computations of net capital and aggregate indebtedness or of minimum net worth (Cal. Code Regs., tit. 10, section 260.241.3, subd. (j)), failed to maintain general and auxiliary ledgers (Cal. Code Regs., tit. 10, section 260.241.3, subd. (a)(2)), and failed to file annual financial reports with the Commissioner (Cal. Code Regs., tit. 10, section 260.241.2, subd. (a).) The books and records requirements and the annual report filing requirements provide the Department with a regulatory mechanism to validate a firm's liquidity and financial integrity to ensure that licensees maintain the necessary net capital for the protection of the public. VCM's failure to meet its reporting requirements prevented the Department from determining, as part of its regulatory examination, if VCM met the capital requirements imposed by the Corporate Securities Law of 1968 and the regulations enacted thereunder.

4. Corporations Code section 25241 requires investment advisers to maintain books and records that are subject to examination and to file such reports as required by the Commissioner. Section 25241 provides, in relevant part, the following:

(a) Every broker dealer and every investment adviser licensed under Section 25230 shall make and keep accounts, correspondence, memorandums, papers, books, and other records and shall file financial and other reports as the commissioner by rule requires

5. California Code of Regulations, title 10, section 260.241.2, subdivision (a) requires the filing of an annual report by certain investment advisers. Subdivision (a)(2) of section 260.241.2 provides as follows:

(a) General Rule. Subject to the provisions of Subsection (c) of this section, . . . every licensed investment adviser subject to the provisions of Section 260.237.1 or Section 260.237.2, as applicable, of these rules, shall file an annual financial report containing the information required by a form or forms to be supplied or approved by the Commissioner, as follows:

. . .

(2) The annual report for investment advisers shall contain a Statement of Financial Condition. Supporting schedules shall contain computations of net capitals, aggregate indebtedness and ratios required under Section 260.237.1 or minimum financial requirements

1 required under Section 260.237.2, as applicable, and the certificate of the accountant required
2 under subsection (c) of Section 260.237 of these rules.

3 6. California Code of Regulations, title 10, section 260.241.3 requires that investment
4 advisers maintain specific books and records. Section 260.241.3, in relevant parts, provides as
5 follows:

6 (a) Every licensed investment adviser shall make and kept true, accurate and current the
7 following books and records, relating to such person's investment advisory business:

8 (2) General and auxiliary ledgers (or other comparable records) reflecting asset, liability,
9 reserve, capital, income and expense accounts.

10 (j) Any investment adviser who is subject to the minimum financial requirements of Section
11 260.237.1 or Section 260.237.2, as applicable, shall, in addition to the records otherwise
12 required under this section, maintain a record of the proof of money balances of all ledger
13 accounts in the form of trial balances and a record of the computations of net capitals and
14 aggregate indebtedness pursuant to Section 260.237.1 of these rules or minimum net worth
15 pursuant to Section 230.237.2 of these rules (as of the trial balance date). The trial balances
16 and computations shall be prepared currently at least once a month.

17 7. California Code of Regulations, title 10, section 260.237.1, subdivision (a)(2),
18 provides, in relevant part, as follows:

19 An investment adviser licensed prior to 03/01/03 may comply with either the minimum
20 financial requirements in this section or in Section 260.237.2 until January 1, 2005, at which
21 time this section shall become inoperative and an investment adviser shall comply with the
22 minimum financial requirements in Section 260.237.2.

23 (a) No investment adviser who has any power of attorney from any investment advisory
24 client to execute transactions . . . shall permit its total aggregate indebtedness to exceed 500%
25 of its tangible net capital or permit its current aggregate indebtedness to exceed its current net
26 capital; and,

27 (2) If the investment adviser has any power of attorney from any investment advisory client
28 to execute transactions and does not have regular or periodic custody or possession of any of
its investment advisory clients' securities or funds, except the receipt of prepaid subscriptions
for periodic publications, or other investment advisory services, it shall at all times have and
maintain tangible net capital of not less than \$5,000

Subdivision (c) of section 260.237.1 provides that for purposes of section 260.237.1,
subdivision (a), all financial information shall be determined in accordance with generally accepted
accounting principles.

8. California Code of Regulations, title 10, section 260.237.2, in relevant part, provides
as follows:

1 An investment adviser licensed prior to 03/01/03 may comply with either the minimum
2 financial requirement in this section or in Section 260.237.1 until January 1, 2005, at which
3 time Section 260.237.1 shall become inoperative and an investment adviser shall comply with
the minimum financial requirement in this section.

4 (a) Every investment adviser who has custody of client funds or securities shall maintain at
5 all times a minimum net worth of \$35,000, and every investment adviser who has
6 discretionary authority over client funds or securities but does not have custody of client
funds or securities shall maintain at all times a minimum net worth of \$10,000.

7 9. The Department's examiner found during the regulatory examination on January 12,
8 2004, that VCM had discretionary authority and power of attorney over advisory client accounts to
9 execute transactions and, therefore, VCM was required to meet either the net capital provided for
10 under section 260.237.1, subdivision (a)(2), or the minimum net capital requirements provided for
11 under section 260.237.2, subdivision (a), and to show proof of compliance with this regulation by
12 filing annual financial reports, in accordance with California Code of Regulations, title 10, section
13 260.241.2, subdivision (a). VCM was also required to prepare and maintain monthly proof of ledger
14 account money balances and either monthly computations of net capitals and aggregate indebtedness,
15 or monthly computations of minimum net worth, in accordance with California Code of Regulations,
16 title 10, section 260.241.3, subdivisions (a)(2) and (j). At the time of the January 12, 2004
17 examination, VCM had not prepared and maintained monthly proof of ledger account money
18 balances and either monthly computations of net capitals and aggregate indebtedness, or of minimum
19 net worth, in violation of California Code of Regulations, title 10, section 260.241.3, subdivisions
20 (a)(2) and (j). As a result of VCM's violation of California Code of Regulations, title 10, section
21 260.241.3, subdivisions (a)(2) and (j), the Department's examiner was unable to determine if the
22 firm, at the time of the examination, was in compliance with either the net capital requirements of
23 section 260.237.1, or the minimum net worth requirement of section 260.237.2.

24 10. The Department's examiner also found that VCM had failed to submit its annual
25 financial reports for the years 2001 and 2002 in violation of California Code of Regulations, title 10,
26 section 260.241.2, subdivision (a).

27 11. On March 29, 2004, the Department sent Armijo a regulatory letter explaining the
28 violations discovered during the January 12, 2004 examination, including violations of California

1 Code of Regulations, title 10, sections 260.241.3, subdivisions (a)(2) and (j), and 260.241.2,
2 subdivision (a)(2). Armijo responded by letter dated April 7, 2004. In his letter, Armijo stated
3 “VCM computations of aggregate indebtedness and net capital are now prepared and maintained on a
4 monthly basis.” In addition, VCM “now reflect the unearned portion of the advisory fees and have
5 recognized and recorded them as a liability on our financials.” Armijo, however, did not provide any
6 explanation why VCM had not corrected the deficiencies prior to the 2004 regulatory examination.
7 Armijo enclosed the annual financial reports for years 2001 and 2002. Armijo vowed to file timely
8 reports in the future.

9 12. A prior regulatory examination of VCM conducted by the Department in March 2001
10 revealed, in part, identical regulatory violations. On May 8, 2001, the Department sent a letter
11 notifying VCM, among other things, of VCM’s failure to record the unearned fees as a liability,
12 compute net capital and aggregate indebtedness on a monthly basis and file annual reports in
13 violation of California Code of Regulations, title 10, sections 260.241.3, subdivisions (a)(2) and (j),
14 and 260.241.2, subdivision (a). In correspondence with the Department dated May 15, 2001, Armijo
15 stated VCM “now maintains our general ledger on a monthly basis. Our computations of net capital
16 are prepared on a monthly basis along with reconciling the bank accounts. Unearned income is
17 established as part of our accounting records.”

18 13. Corporations Code section 25252 authorizes the Commissioner to issue an order
19 levying administrative penalties against any investment adviser for willful violations of any provision
20 of the Corporate Securities Law of 1968 and any rules promulgated thereafter. Specifically,
21 Corporations Code section 25252 provides, in relevant part:

22 The commissioner may, after appropriate notice and opportunity for hearing, by orders, levy
23 administrative penalties as follows:

24 (b) Any broker-dealer or investment adviser that willfully violates any provision of this
25 division to which it is subject, or that willfully violates any rule or order adopted or issued
26 pursuant to this division and to which it is subject, is liable for administrative penalties of not
27 more than five thousand dollars (\$5,000) for the first violation, not more than ten thousand
28 dollars (\$10,000) for the second violation, and not more than fifteen thousand dollars
(\$15,000) for each subsequent violation.

1 14. By reason of the foregoing, VCM willfully violated California Code of Regulations,
2 title 10, sections 260.241.2, subdivision (a) and 260.241.3, subdivisions (a)(2) and (j), justifying the
3 imposition of administrative penalties. VCM, as a licensee, was obligated to have knowledge of, and
4 to comply with, the provisions of the Corporate Securities Law of 1968 and the regulations
5 thereunder to maintain its investment adviser certificate. Furthermore, on May 15, 2001, the
6 Department notified VCM of the requirements of California Code of Regulations, title 10, sections
7 260.241.2, subdivision (a) and 260.241.3, subdivisions (a)(2) and (j). VCM violated these sections
8 again, despite the Department's actual notification.

9 15. Therefore, pursuant to Corporations Code section 25252, the Commissioner seeks
10 administrative penalties for VCM's willful violations of the Corporate Securities Law of 1968 and
11 the regulations adopted pursuant to it.

12 Wherefore, good cause showing, and pursuant to Corporations Code section 25252, the
13 California Corporations Commissioner prays for an order levying administrative penalties in the
14 amounts as follows, for willful violations of the following sections of title 10 of the California Code
15 of Regulations: section 260.241.2, subdivision (a) --\$750.00, section, 260.241.3, subdivision (a)(2) --
16 \$750.00 and section 260.241.3, subdivision (j) --\$750.00, for a total of \$2,250.

17 Dated: May 13, 2005
18 Los Angeles, California

WAYNE STRUMPFER
Acting California Corporations Commissioner

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20 By: _____
21 MARLOU de LUNA
22 Corporations Counsel
23 Enforcement Division
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